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SUBJECT: INFLATION COMING DOWN, BUT PERSISTENT HIGH FOOD PRICES SLOWING THE FALL

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¶1. (U) Key Points:

-- Overall inflation has been falling for most of the year and hit a 20-month low of 9% in August; however, food price inflation has been very strong all through 2009.

-- The supply chain for food is full of inefficiencies which exacerbate high food price problems. The Government of Egypt (GOE) is trying to address some of them by improving infrastructure.

-- The Central Bank of Egypt (CBE) seems unconcerned by inflation and is focused on spurring economic growth. The CBE has cut interest rates six times so far this year.

Food Prices High This Year

¶2. (SBU) Inflation in Egypt has been coming down from its peak in summer 2008, but it has fallen at a slower pace than economists expected. The rate reached a 20-month low of 9% year-on-year (y-o-y) in August, down from its peak of over 20% last summer, but then increased to 10.8% in September. Food prices were up 17.4% y-o-y in September. Food price inflation has been very strong all through 2009, driven mainly by fruit and vegetable prices according to Simon Kitchen, Vice President of EFG-Hermes, a regional leading investment bank. In addition, rising global sugar prices drove up domestic sugar prices in September, and demand during Ramadan drove up food prices over the past few months. Food prices have a strong effect on the overall price index because food accounts for about 44% of Egypt's consumer price index.

The "Ramadan Effect"

¶3. (SBU) Increased demand pushes up food prices before and during Ramadan, which ran from the end of August to the end of September, since household spending on food increases significantly due to higher overall consumption despite daily fasting. In addition, some wholesalers and retailers take advantage of the increased consumption and consumer expectations of higher prices by hoarding goods and raising prices, according to Amgad Hegazy, an economist at the Ministry of Finance. In September, food prices increased 55% on an annualized basis after jumping 64% on an annualized basis in August and 44% in July.

¶4. (SBU) Egypt's economic slowdown does not appear to have impacted demand during Ramadan. Press reports and anecdotal evidence from lower, middle, and upper income markets suggest that demand for Ramadan related goods remained high and similar to last year. Hotel managers also reported that

demand for venues for Iftar, the nightly breaking of the fast celebration, was the same as last year.

Problems in the Food Supply Chain

¶ 15. (SBU) Last year's global decline in food commodity prices did not fully transfer to Egyptian domestic prices. Food prices are sticky downwards, according to Reham El Desoki, economist at Beltone Research, who attributes this to a lack of market information that allows sellers to markup their prices without consumers realizing it. Hanaa Kheir-El-Din, executive director of the Egyptian Center for Economic Studies also attributed it to monopolistic practices throughout the supply chain, especially distribution.

GOE Tools to Bring Down Inflation

¶ 16. (U) The Central Bank of Egypt has not increased interest rates to reduce inflation because it assessed that the high inflation is coming from high volatility in food prices and, in its opinion, does not represent underlying inflationary pressures. The Central Bank is primarily focused on encouraging economic growth and has cut interest rates six times this year.

¶ 17. (U) Minister of Trade and Industry Rachid M. Rachid laid out a plan at the end of last month (reftel) to invest in domestic infrastructure to significantly improve the domestic supply chain and the movement of products to improve consumer

access to those products which should bring down prices over the long-term.

Comment

¶ 18. (SBU) High and rising food prices are hard on the average Egyptian, and especially hard on the poor who spend a disproportionate amount of their income on food. Egyptians have also noticed, and complain that when international food prices rise, domestic ones do too, but when international prices fall, that decrease in price is not passed on to them.

Egyptians are looking to the GOE to bring down food prices, but the GOE has limited straight-forward tools to do so. Successful Ministry of Trade and Industry efforts to improve the supply chain and movement of goods could help bring down costs in the long run, but the GOE's track record in this area gives some reason for skepticism. Further, there have been no specific discussions about tackling monopolistic practices in the supply chain which could undermine gains made in other areas. High and rising food prices will also make it difficult for the GOE to reduce its spending on food subsidies, one of the major drains on the budget.

Scobey